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SUBJECT: DIALOGUE FINDS CONSENSUS ON SOCIAL SECURITY REFORM

REF: PANAMA 1352 AND PREVIOUS

11. (U) THIS MESSAGE IS SENSITIVE BUT UNCLASSIFIED. PLEASE PROTECT ACCORDINGLY.

SUMMARY

12. (SBU) According to Second Vice President Ruben Arosemena, Panama's National Dialogue on Social Security (Caja de Seguridad Social - "CSS") achieved consensus on reforms aimed at restoring the financial viability of the CSS system. Second Vice President Ruben Arosemena told ECON and POL Chiefs Dec. 2 that the GOP worked to ensure a success because "the governability of the country was at stake." The National Assembly will likely approve the package before January, as the deal represents a hard-won consensus among key business, labor, and civic leaders, as well as GOP promises to make CSS self-sustaining - eventually. The CSS Dialogue has strengthened Torrijos' political hand, eroded support for top GOP antagonists, such as FRENADESSO, and gives the GOP added momentum to pursue other key economic goals such as a bilateral Free Trade Agreement (FTA) with the U.S. and possibly expansion of the Panama Canal. But the agreement will cost the GOP a lot of money. The price for the accord is a GOP commitment to "temporarily" make up a projected \$7.2 billion shortfall in the CSS retirement account over the next five decades, which the already cash-strapped government maintains in can handle. End summary.

National Dialogue Delivers Politically Viable Approach

13. (U) After five months and 89 sessions, Panama's National Dialogue on Social Security (Caja de Seguridad Social - "CSS") delivered an agreement among GOP, business leaders, labor, and civil society on how to reform the existing CSS to keep it from going bankrupt. The Torrijos administration convened a 90-day National Dialogue in late June to defuse growing public unrest over the GOP's May 2005 passage of Law 17 on CSS reform (reftel). At the same time, the GOP suspended implementation of Law 17, which would have, inter alia:

- raised retirement ages from 57 to 60 for women and from 62 to 65 for men;
- increased payroll contributions to the CSS from 7.25% to 9% for employees and from 10.75% to 13.25% for employers; and,
- raised the minimum period of contributions from 15 years to 25 years for eligibility.

14. (SBU) Negotiations advanced fitfully, forcing the GOP to extend the original 90-day deadline. The leftist-inspired "National Front for Defense of Social Security" (FRENADESSO), which was one of the main forces behind last June's street demonstrations against Law 17, joined the Dialogue on July 5 and promptly disrupted its proceedings with chants of protest. FRENADESSO's aggressive tactics and unhelpful antics prompted other Dialogue participants to accuse them of attempting to sabotage the process. Following several weeks of difficult negotiations, FRENADESSO and the construction workers' union (SUNTRACS) abruptly quit the process on November 8. This effectively cleared the way for the remaining negotiators to announce an apparent breakthrough on Nov. 11, with agreement on a mixed system (individual accounts combined with CSS payouts). By Nov. 20, the Dialogue concluded with consensus on several contentious points, including:

- maintaining retirement ages at 57 for women and 62 for men;
- set employee payroll contributions at 6.75% in 2007, going up gradually to 9.25% in 2013 and employer contributions at 2.75% in 2007, rising gradually to 4.25% in 2013 (Note: substantially less than under Law 17);
- gradually raise the minimum period of contributions from 15 years to 20 years for eligibility;
- cover contributors with income less than \$500/month through a defined-benefits program; contributors with incomes greater than \$500/month will have individual

retirement accounts and will help subsidize the defined-benefits program; and,
-- raise caps on maximum pensions from \$1,500/month to \$2,500/month.

15. (SBU) Second Vice President Ruben Arosemena, who led the GOP's participation in the Dialogue, hailed the Dialogue's outcome as a "victory for the government and for the country." He told Emboffs Dec. 2 that the Dialogue has boosted the self-esteem of Panamanians, as they were able to come together and reach consensus at the negotiating table. Convinced that a GOP failure to manage the CSS issue would have a negative "cascade effect" on other key initiatives, such as possible Panama Canal expansion and a Free Trade Agreement (FTA) with the U.S., Arosemena said the GOP was intent on making the CSS Dialogue a success because "the governability of the country was at stake." He expects President Torrijos will submit a new bill based on the Dialogue's outcome to the National Assembly this week. Most expect the Assembly to approve the bill before January with little or no substantive changes, given the GOP's hard-won consensus among key business and society leaders.

GOP to Pay \$7.2 Billion in "Transitional" Costs

16. (U) To ensure a successful outcome, President Torrijos committed the GOP to putting \$75 million/year into the CSS starting in 2007, increasing to \$100 million/year from 2010 to 2012, and to \$140 million/year from 2013 to 2060. In total, the GOP would put up some \$7.2 billion over the next five decades to cover the CSS' full transition to a mixed system. As the GOP currently contributes only about \$30 million/year to the CSS (but nothing to the retirement program), this is a significant commitment by an already-cash-strapped government.

17. (SBU) Vice President Arosemena expects the GOP will pay this CSS tab through general revenues rather than through any special mechanism. He told Emboffs Dec. 2 that the Ministry of Economy and Finance (MEF) has assured him that the GOP will be able to handle this CSS commitment. MEF's Director of Public Policy told Econoff Dec. 2 that he will recommend cuts in other GOP expenses to cover increased CSS payments. He also expects that any extra GOP deficit spending needed to cover this new CSS commitment will be balanced by increased CSS contributions the GOP is already seeing with Panama's growth in employment. Some private analysts predict the GOP will shoulder its CSS commitment through continued strong economic growth, particularly if it advances with expansion of the Panama Canal.

Comment: CSS Win Boosts GOP Momentum & Prospects for 2006

18. (SBU) The Torrijos administration's quick passage of fiscal and social security reforms in early 2005 sparked intense public backlash, putting the GOP on the defensive for much of the year. Although the GOP's original CSS reforms may have been better formulated technically, they proved politically unviable. The original Law 17 was formulated to make CSS solvent for 35-40 years. The result of the Dialogue is that CSS will achieve solvency in 50 years; meanwhile the GOP will foot the bill. The Dialogue's success strengthens Torrijos' hand in putting forward a consensus package likely to garner both legislative and, more critically, popular support. The Dialogue also appears to have eroded support for top GOP antagonists, such as FRENADESSO, as Panamanians came to see them as more interested in posturing than problem-solving. Coming on top of Torrijos' regained popularity, a recent drop in unemployment, and continued strong economic growth, the momentum appears to have swung in the GOP's favor, putting it on stronger footing for 2006 as it pursues a bilateral FTA with the U.S. and possibly expansion of the Panama Canal.

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